

BPA Rate Pass-Through Alternatives

Seattle City Light is seeking feedback from the Rates Advisory Committee regarding how BPA rates are to be reflected in City Light rates. The staff has proposed three alternatives (the issue paper is attached) that are summarized as follows: 1) Pass through BPA charges to rate payers on the same schedule as BPA charges City Light; 2) Estimate what BPA charges would be and use the estimate in rates; 3) Do #1, but set a dead band above (or below) which charges would have to rise (or fall) before a rate change is made. Options 2 and 3 are intended to provide more rate stability, while Option 1 provides more financial stability for the utility.

The issue is broader than what has been proposed by staff. It goes to expectations of the future course of BPA rates, and the difference between, primarily, BPA's own projections and what to some BPA observers is more likely to happen.

BPA has provided projections of its rates for the next 2 ½ years in documents available on its web site. As projected in December 2003, BPA rates in April 2004 will be \$32.64 per MWh. Those rates are expected to rise to \$33.77, \$34.73, \$33.85 and \$34.63 per MWh in the six month periods beginning October 2004, April 2005, October 2005 and April 2006 periods, respectively. These figures are preliminary from October 2004 on, but, absent a significant cost-reduction effort, discussed below, they are unlikely to change substantially. For Seattle, the increase for the October 2004/September 2005 means approximately \$15 million increase in revenue requirements.

Under Option 1, these increased charges would be passed through to rate payers on the effective dates of the BPA change. Under Option 2, the rates likely would be set, presumably, using the average of the out-year projections of BPA, though they could be set to move as the expected BPA charges move.

Under Option 3, a dead band would be established, but what rate is used as the base level of the dead band has not been established. Not enough information has been provided about the dead band: Is it annual? Does it change every six months corresponding to BPA's rate periods? If annual, how would it work with the seasonal changes, and in which season does it start? That is, does the dead band prevent seasonal increases or seasonal decreases from being passed through to rate payers? There are many questions.

Based on the judgment of those closely involved in BPA rate cases, BPA rates are unlikely to rise above projections. But they could fall—and they could fall substantially—for the following reasons: BPA is under heavy pressure to reduce its rates, both in the legal and political arena. In particular, politically, BPA is striving to avoid any rate increase in October 2004—that is, one month before the election. Avoiding an increase would mean that BPA's rates would remain at approximately \$32.64 per MWh instead of rising to \$33.77 per MWh. Legal success against BPA would reduce the rates even more, and possibly for 2006.

How do these projections fit with the options? Option 1 would pass through any reductions, so the projections themselves are immaterial. A projection of rates for Option 2, however, would require a projection of the success of legal action—a difficult task. A conservative assumption on legal success would likely result in Seattle City Light rates set on the basis of the original BPA projections.

Option 3 has the chief drawback that it appears to be unbalanced. If there is little likelihood of rate increases and some likelihood of rate reductions, the dead band would work against passing the benefit of lower rates back to the Seattle rate payers and economy. That is, it is likely the dead band would simply allow SCL to avoid rate reductions. The stability that the dead band provides would be at a cost to the economy.

Proposed RAC position: Continuing to pass through BPA costs seems to provide the best alternative.

Issue 2. Will we continue to pass through changes in BPA rates?

In January 2001, as the City Council considered City Light's request for a rate increase to deal with the deepening western power crisis, there was great uncertainty regarding the rates that the Bonneville Power Administration (BPA) would charge when its new contract with City Light went into effect on October 1, 2001. At that time estimates of the prospective BPA rate increase ranged as high as 225%. Since BPA costs represented a significant portion of City Light's revenue requirements, the size of the BPA rate increase had a major impact on the size of the City Light rate adjustment that would be required. Rather than basing its rate action on a prediction of the BPA rate adjustment, the Council decided to include in the rate ordinance (Ordinance 120247) a requirement that the effect of the BPA rate adjustment be passed through to City Light ratepayers by increasing all energy charges by a fixed amount per kilowatt-hour. (Low-income customers were to receive one-half the increase of standard customers.) In May 2001, when the Council passed Ordinance 120385 increasing rates effective July 1, 2001, the pass-through provision was clarified to require the pass-through of BPA rate decreases as well as increases.

On October 1, 2001 BPA increased its rates by 65%. City Light rates were raised by an average of 9.5% to pass this increase on to ratepayers. (There was an additional increase of 0.8% to pass-through BPA transmission rate increases. This pass-through was required by the rate ordinance that was passed in November 1999 and was a one-time occurrence.) When BPA rates decreased on April 1, 2002, City Light adjusted its rates downward by about 1.1%; BPA increases on April 1, 2003 were reflected in an increase of 1.2% in City Light rates. BPA plans to adjust its rates at six-month intervals at least through 2006.

Alternatives:

1. Continue to comply with the pass-through requirement as BPA changes its rates.
2. Remove the pass-through requirements from the Seattle Municipal Code. Set rates effective 2005 on the basis of the best available information regarding BPA rates.
3. Amend the pass-through requirement to provide that BPA rate changes be passed through only if they would increase or decrease City Light's costs by more than a predetermined amount (e.g., \$20 million).